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C O N F I D E N T I A L SECTION 01 OF 03 BERLIN 001151

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TAGS: ECON EFIN ELAB PREL GM
SUBJECT: MERKEL TARGETS BANKERS IN RUN-UP TO G-20 SUMMIT

REF: A. BERLIN 1138
¶B. BERLIN 758

Classified By: A/EMIN INGRID KOLLIST FOR REASONS 1.4 (B) AND (D)

¶1. (C) SUMMARY. Days before national elections in Germany, Chancellor Angela Merkel will fly to the other side of the Atlantic to attend the G-20 Summit in Pittsburgh. This is a decision taken by a leader confident not only in her re-election prospects, but also in her mission to push through Germany's agenda for the G-20. Pre-cooked with other European partners, the agenda is ambitious -- from enhancing regulation and supervision to raising capital requirements for banks. Given the timing just before Germany's elections, however, bankers' compensation has emerged as Merkel's top priority. Also important to the Germans is a robust discussion on exit strategies: Finance Minister Peer Steinbrueck is concerned that continuing government interventions in the economy may be sewing the seeds of the next crisis. Finally, Chancellor Merkel is going to Pittsburg to market her signature initiative, the Charter for Sustainable Economic Activity, which has made it onto the Summit agenda. Despite the pressures of a looming election, Merkel is not highlighting transatlantic disagreements. END SUMMARY.

ELECTION? WHAT ELECTION?

¶2. (C) The G-20 Summit in Pittsburgh takes place just two days before the September 27, 2009 national elections in Germany. That Chancellor Angela Merkel (CDU) has decided to attend the Summit says as much about her campaign strategy (REF A) as it does about her lead in the polls. With relatively few major issues to distinguish her from her principal rival, Foreign Minister Frank-Walter Steinmeier (SPD), she will use the Summit to reinforce her image back home as a strong and effective leader. Her principal partner in managing the financial and economic crisis, Finance Minister Peer Steinbrueck (SPD), will be at her side in Pittsburgh. Meanwhile, Foreign Minsiter Steinmeier, will sit out both the G-20 Summit and the United Nations General Assembly (UNGA). Some 14 points behind Merkel in recent polls, he may need all the extra time campaigning he can get.

DEAR FREDRIK

¶3. (C) On September 3, 2009, Chancellor Merkel joined French President Nicolas Sarkozy and UK Prime Minister Gordon Brown in signing a joint letter on the G-20 Summit addressed to President of the European Council Fredrik Reinfeldt. Sandro Maluck, an economic advisor at the Chancellery, told us this letter best articulates what the Chancellor hopes to achieve

in Pittsburgh. He added that the letter would largely frame discussions at the September 17, 2009 Special European Council on Financial Crisis in Brussels. The priorities include, among others, discussion of exit strategies from government interventions in the economy, limiting financial sector compensation, enhancing financial sector regulation and supervision, increasing capital requirements for financial institutions, further cracking down on tax havens, reforming the International Monetary Fund (IMF), and adopting a Charter for Sustainable Economic Activity.

¶4. (C) Lucinda Trigo, Division for Global Economy, Currency Issues, IMF and G7/G8, Ministry of Finance, described for us a few additional German priorities, particularly focusing on financial sector regulation and supervision: namely, ensuring all financial institutions, markets and instrument are subject to regulation; applying regulation consistently to create a level playing field; and compelling those who triggered the crisis to bear the cost. (NOTE: These are among the points detailed in Finance Minister Steinbrueck's August 27, 2009 letter to G-20 Finance Ministers.) Both Merkel and Steinbrueck agree, however, that Germany's number one goal for the Summit is to get an agreement on limiting financial sector compensation.

ISSUE NUMBER ONE: COMPENSATION

¶5. (C) Chancellor Merkel apparently has it in for bankers: at a September 15, 2009 campaign rally in Koblenz, Merkel said, "We must make sure that the bankers of this world can never again get up to such things at our cost." Some of this is probably campaign theatrics. Later the same day in the

financial capital, Frankfurt, Merkel conveniently left that line out of her speech. Electioneering aside, Merkel seems genuinely to believe that risky behavior by banks was at the root of the financial crisis. She wants the G-20 to prevent banks from becoming so large and systemically important that they can "blackmail" governments. Merkel also wants to ensure that taxpayers do not have to pick up the tab for banks' risky activities.

¶6. (C) Limiting bankers bonuses is a political win-win for Merkel: it gives the appearance of addressing some of the incentives that led to the financial crisis, but it deflects blame for the crisis away from politicians) indeed, away from Germany, since the crisis was the fault of Wall Street, so the thinking goes. Merkel's idea is for the G-20 to establish binding principles that link financial sector compensation, including variable pay or bonuses, to long-term performance. Unlike media reports about other European countries' priorities, however, Germany opposes a bonus specific cap, according to Lucinda Trigo. In Pittsburgh, Merkel will point to steps Germany has already taken: Germany's bank regulator Bafin unveiled new rules in August that force bankers to repay bonuses if they take unjustifiable risks. Bonuses are tied to the success of the organization as a whole, and banks have until the end of 2009 to comply.

¶7. (C) Outside the government, however, there is skepticism. Holger Martin, an advisor on economic affairs, EU policy and international relations at the Association of German Banks told us his organization's constituents were strongly opposed to further limits, fearing difficulty in attracting talent. Economist Stormy-Annika Mildner of the German Institute for International and Security Affairs (SWP) told us European rhetoric over limiting bonuses should be taken with a grain of salt, since there was no chance of getting a binding EU agreement, much less an international one. Even among those European countries favoring reform, there are different approaches.

DEVIL IN THE DETAILS: CAPITAL REQUIREMENTS

¶8. (C) As part of addressing the "too-big-to-fail" conundrum, Germany supports imposing higher capital requirements on big banks and encouraging banks to build up capital buffers, Lucinda Trigo of the Finance Ministry told us. (Note: Germany also proposes developing an international convention to facilitate the insolvency of large, internationally active banks.) Bernd Brabaender, Managing Director for Economic Affairs, Association of German Banks, is not pleased with current European thinking on capital requirements, however. Brabaender wants absolute leverage ratios to be used as a "trigger for supervisors to target a bank for closer inspection, not as a hard leverage ratio, US-style." The Chancellery's Sandro Maluck told us that capital requirements could in fact be a sticking point in Pittsburgh, given the asymmetric implementation of Basel II in Europe and the United States. He added that the "definition of capital" is different in European and the United States.

GETTING THE TOOTHPASTE BACK IN THE TUBE

¶9. (C) Finance Minister Steinbrueck told Ambassador Murphy he was actually quite content with the G-20's progress on many fronts. G-20 partners had agreed on 95 percent of the agenda at the G-20 Summit in London, and 40-50 percent of decisions taken at the Washington Summit have already been implemented. Steinbrueck said he was now increasingly focused on "exit strategies" from fiscal stimulus plans, bank rescue operations, and central bank liquidity provisions undertaken to counteract the crisis. While agreeing the measures should be maintained for the time being, Steinbrueck is concerned that extraordinary interventions in the economy could lead to the next crisis if not curtailed at the appropriate time and in a coordinated manner. "How can you get the toothpaste back into the tube?" he asked Ambassador Murphy rhetorically. Juergen Stark, Member of the Executive Board of the European Central Bank (ECB) is asking the same questions. He notes that interventions by Eurozone governments and the ECB together totaled around 40 percent of Eurozone GDP. It is not yet time to implement exit strategies, Stark argues, but discussing them now will reassure markets.

A CHANCELLOR BEARING GIFTS

¶10. (SBU) One of Chancellor Merkel's top priorities is an initiative known as the "Charter for Sustainable Economic Activity," a set of non-binding principles for the conduct of economic policy, which Merkel hopes G-20 members will endorse in Pittsburgh (REF B). Chancellor Merkel sees the Charter as a means of ensuring that "sustainability is a fundamental principle of the global economy," and a way to prevent future crises.

¶11. (C) According to Alexander Schieferdecker, an economic advisor at the Chancellery, the "core values document" agreed at the September 9 meeting on the Charter in Washington is, in fact, "not the Charter itself, but a basis for further work on the Charter." He added that this "core values document" should be a "building block" for the G-20 Summit communique, and efforts are currently under way to link the two. Despite Brazil's and India's insistence at the September 9 meeting that there be no further work on the Charter after Pittsburgh, the Chancellor is determined to move the process forward. "She is very strong on this initiative," he said. "She even raised the Charter in her televised debate on September 13 with Steinmeier." (NOTE: The U.S. co-chairs a task force on the Charter along with Germany and South Africa.)

THE G QUESTION

¶12. (C) On the question of which international forum is best suited for overall coordination of economic governance, there is still a variety of opinions within the German government. Finance Minister Steinbrueck told Ambassador Murphy that he

saw a continued role for the G-7, and that Germany would not want to "give it up." He noted the different interests represented in the two bodies, citing Korea as an example of a country that is in the G-20 but not in the G-7. (NOTE: Finance Ministry officials have previously expressed their frustration at seeing the G-20 transformed from a gathering of finance ministers and central bankers into one dealing with a wider brief.)

¶13. (C) Chancellery contacts see the issue differently, and told us the G-20 had effectively already emerged as the preeminent forum. The fact that Merkel's chief economic advisor, Jens Weidmann is the G-20 (but not G-8) Sherpa certainly contributes to shaping this view. Chancellor Merkel's showcase project, the Charter for Sustainable Economic Activity, which covers a wide variety of areas -- financial markets, environment, trade, and development, among others -- is after all a G-20, not G-8 project. The growing ability of EU members of the G-20 to coordinate their positions, said Maluck, is a key factor helping to shape the increasing importance of the G-20.

COMMENT

¶14. (C) The Germans' tone heading into the G-20 Summit in Pittsburgh is far more constructive than it was prior to last April's Summit in London. Despite a looming election, there are fewer ultimatums and anti-Anglo Saxon sound-bites than last spring, when Chancellor Merkel joined forces with President Sarkozy to complain, disingenuously, about U.S. pressure to increase fiscal stimulus programs and resist financial market regulation. Certainly, there are areas where Germany and the United States have different emphases. The extent to which financial sector compensation should be limited is a point of discussion, as are the details surrounding capital requirements. (IMF reform is another area where we may not see eye-to-eye, though the annual meeting in Istanbul, a few weeks later, is likely to take up that discussion.) The overall dynamic, however, is vastly improved. U.S. engagement on Merkel's Charter, while probably not the overriding factor, has contributed to more goodwill on the German side. The villain this time around is bankers, who appear set to have their wings clipped in Pittsburgh, if Merkel, Sarkozy and others get their way. END COMMENT.
Murphy